STATE OF MICHIGAN
IN THE SUPREME COURT
APPEAL FROM COURT OF APPEALS
Cavanagh, P.J., Jansen and Gage, J.J.

FLUOR ENTERPRISES, INC.,

Plaintiff-Appellee,

v

REVENUE DIVISION, DEPARTMENT OF TREASURY, STATE OF MICHIGAN,

Defendant-Appellant.
_____/

Supreme Court No. 129149

Court of Appeals No. 251005

Lower Court Case No. 02-27-MT

BRIEF ON APPEAL - APPELLANT

ORAL ARGUMENT REQUESTED

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QUESTION PRESENTED FOR REVIEW

I. The United States Supreme Court has held that to be valid under the Commerce Clause, US Const, art I, § 8, cl3, a State tax statute must be internally consistent. Internal consistency requires that if every State adopted a provision like the statute in question, a taxpayer would not be subject to tax in more than one jurisdiction for the same transaction. Section 53(c) of the Single Business Tax Act, MCL 208.53(c), which is presumed to be constitutional, provides: "Receipts derived from services performed for the planning, design, or construction activities within this state shall be deemed Michigan receipts." The question is whether MCL 208.53(c), when properly analyzed under the internal consistency test, would result in a taxpayer being subject to tax in more than one jurisdiction for the same transaction.

STATEMENT OF PROCEEDINGS AND FACTS

Introduction

Plaintiff-Appellee, Fluor Enterprises, Inc., ("Fluor") had numerous Michigan design and build projects during the years at issue—November 1, 1988, through October 31, 1994—including projects at Marathon Oil Company, TRW Vehicle Safety Systems, Ford Motor Company, Midland Cogeneration, and others. Fluor's audit by the Department of Treasury revealed that Fluor failed to properly characterize receipts derived from services performed for Michigan construction projects as Michigan sales. The Court of Claims adopted Fluor's contention that the statute does not count as Michigan sales all services performed for Michigan construction projects, such as architectural services performed in California. The Court of Appeals disagreed with the Court of Claims, finding that the statute at issue was not ambiguous and that the statute clearly indicated that services performed out of Michigan on construction projects in Michigan, such as engineering or architectural services, were "Michigan" sales. However, the Court of Appeals further determined that the application of the statute in question, § 53(c) of the Single Business Tax Act, violated the internal consistency test of the Commerce Clause of the U. S. Constitution and was therefore unconstitutional.

A. Factual Background

The parties executed a Stipulation of Facts to provide a factual context for the Court of Claims to rule on the parties' cross motions for summary disposition.[1] Pertinent facts are briefly summarized below.

Fluor is a multi-national engineering, construction, and technical service company with its principal place of business in Irvine, California.[2] At issue are services Fluor performed for

[1] Stipulation of Facts, Appellant's Appendix, p 11a-15a.
[2] Stipulation of Facts, ¶¶1, 4, Appellant's Appendix, p 12a.

Michigan construction projects.[3] Fluor performed construction management and construction material procurement activities in Michigan for these projects.[4] It also conducted engineering and architectural services for Michigan projects at Fluor facilities outside of Michigan.[5] An audit of Fluor revealed that Fluor had counted its management and procurement activities in Michigan as Michigan sales but neglected to include engineering and architectural services performed for Michigan projects at Fluor California offices as Michigan sales.[6] Fluor was assessed for the deficiency for tax in the amount of $182,312.00, and interest of $161,028.96.[7] Fluor paid the assessment under protest and sought a refund of $343,618.31 plus additional accrued interest.[8]

B. Legal Background

1. The Single Business Tax Act, MCL 208.1 *et seq.*

The Single Business Tax Act ("SBTA"),[9] levies a value-added tax against any person with business activity within the State of Michigan.[10] A value-added tax measures a firm's total business activity.[11]

During the years in issue, November 1, 1988 through October 31, 1994, the SBTA imposed a specific tax of 2.35% on the adjusted tax base of every person with business activity in this state that is allocated or apportioned to this state.[12] "Business activity" is defined as[13]:

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[3] Stipulation of Facts, ¶ 7, Appellant's Appendix, p 12a.
[4] Stipulation of Facts, ¶ 6, Appellant's Appendix, p 12a.
[5] Stipulation of Facts, ¶ 7, Appellant's Appendix, p 12a.
[6] Stipulation of Facts, ¶ 12, Appellant's Appendix, p 13a.
[7] Stipulation of Facts, ¶ 13, Appellant's Appendix, p 13a.
[8] Stipulation of Facts, ¶ 21, Appellant's Appendix, p 14a.
[9] 1975 PA, No. 228; MCL 208.1 *et seq*.
[10] *Trinova Corp v Michigan Treasury Dep't*, 498 US 358; 111 S Ct 818; 112 L Ed 2d 884 (1991).
[11] *Trinova Corp*, 498 US at 364.
[12] MCL 208.31(1).
[13] MCL 208.3(2).

> a transfer of legal or equitable title to or rental of property . . . or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, within this state . . . .

The single business tax ("SBT") "tax base" is defined as "business income" subject to certain adjustments.[14] "Business income" is further defined as federal taxable income.[15] Section 9 of the SBTA requires certain adjustments to business income, either subtraction or additions, prior to the computation of the tax.[16] These adjustments change the tax base from one derived from income to one derived from business activity. "The tax base computation is designed to calculate the contribution each business made to the total economy; in economic terms, this contribution is the economic size of the business. Each business will pay tax proportionate to its economic size."[17]

Taxpayers whose business activities are confined solely to Michigan have their entire tax base allocated to Michigan, while a taxpayer, such as Fluor, whose business activities are taxable both within and without Michigan, has its tax base apportioned to Michigan.[18]

The formula used for apportioning the tax consisted of the sum of the sales factor, the payroll factor, and the property factor, divided by 3.[19] "The sales factor is a fraction, the

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[14] MCL 208.9(1).
[15] MCL 208.3(3).
[16] MCL 208.9.
[17] Kasischke, *Computation Of The Michigan Single Business Tax: Theory And Mechanics*, 22 Wayne L Rev 1069, 1070 (1976).
[18] MCL 208.40; MCL 208.41.
[19] For tax years beginning after December 31, 1990 and before January 1, 1993 the apportionment formula consisted of the sum of the following percentages:

(a) The property factor multiplied by 30%.
(b) The payroll factor multiplied by 30%.
(c) The sales factor multiplied by 40%.

And for the years in issue beginning after December 31, 1992:

(a) The property factor multiplied by 25%.
(b) The payroll factor multiplied by 25%.
(c) The sales factor multiplied by 50%.

MCL 208.45(4), as amended by 1991 PA 77, § 1.

numerator of which is the total sales of the taxpayer in this state during the tax year, and the denominator of which is the total sales of the taxpayer everywhere during the tax year."[20]

At issue in this matter is the calculation of Fluor's sales factor.

Section 52 of the SBTA[21] dictates when the sale of tangible personal property is in Michigan, while section 53 covers other sales, such as the sale of services.[22]

This case involves the application of § 53, which provides as follows:

> Sales, other than sales of tangible personal property, are in this state if:
> (a) The business activity is performed in this state.
> (b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.
> **(c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts.**
> (Emphasis added).

It is subsection (c) that controls the disposition of this case. The effect of this section is that services performed for construction projects located in Michigan are considered Michigan sales. The effect of § 53(c) on Fluor is to increase its Michigan sales factor by the amount of receipts for services performed for construction projects located in Michigan. The SBTA does not tax sales.

Fluor argued below that the planning and design services it performs outside of Michigan, which are for construction projects in Michigan, should not or could not be treated as Michigan receipts. In essence, Fluor wanted to apportion a smaller percentage of its tax base to Michigan, thereby lowering its SBT liability.

The question presented to the Court of Appeals was how Fluor's SBT tax base should be apportioned. Fluor contended that it should be able to exclude its design services from its other

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[20] MCL 208.51(1).
[21] MCL 208.52.
[22] MCL 208.53.

building activities when calculating its Michigan sales related to Michigan projects. This would act to reduce Fluor's SBT apportioned tax base and the amount of single business tax it would otherwise be required to pay. The Department's long-standing interpretation of the SBTA is that § 53 does not permit this treatment.

C. Procedural History

The Department conducted audits of Fluor for the period November 1, 1988 through October 31, 1994.[23] As a result of the audits Fluor was assessed additional taxes totaling $182,312.00.[24] Fluor was granted a Departmental informal conference in its appeal of the assessment in which the Hearing Referee recommended that the assessments should be canceled.[25]

The then Commissioner of Revenue, June Summers Haas, disagreed with the Departmental Hearing Referee's recommendation and ordered the assessments finalized as the taxes were originally assessed.[26] The Commissioner of Revenue affirmed the assessment in conformity with the Department's long-held interpretation of § 53.

> Treasury's position is that subsection (c) pertains to real property planning, design, engineering, architectural and construction activities. Sales of these types of services are attributed to the state where construction activity (business activity) is to be performed. Receipts for construction related activities with a situs in other states by a Michigan based company subject to apportionment, cannot be attributed to Michigan. The legislative intent, which supports Treasury's position, is embodied in a letter dated July 17, 1975 from the Consulting Engineers of Michigan, Inc. to Senator John Bowman. This letter proposed the addition of subsection (c) and explains the amendment as follows:
>
> > The purpose of this amendment is to increase the ability of the Department of Treasury to tax firms headquartered outside Michigan and designing projects for Michigan. This amendment would raise the tax base for firms headquartered outside Michigan

[23] Stipulation of Facts, ¶¶ 2,12, Appellant's Appendix p 12a-13a.
[24] Stipulation of Facts, ¶ 13, Appellant's Appendix p 13a.
[25] Stipulation of Facts, ¶¶ 14-16, Appellant's Appendix p 13a-14a.
[26] Stipulation of Facts, ¶ 17, Appellant's Appendix p 14a.

> so their tax base is more closely aligned with firms headquartered in Michigan. This amendment would allow Michigan firms to compete more equally with firms outside the state for Michigan projects. This amendment would allow the state to collect a greater tax on Michigan projects designed by out-of-state firms.

> Thus, in examining the letter and the circumstances surrounding the adoption of subsection (c), it is apparent that the legislature intended for the statute to be read as a whole and subsection (c) to be interpreted as pulling in activities performed out of state for construction activities performed within the State of Michigan. The statute, as a whole is interpreted as stating that receipts, derived from services performed out of state, for planning, design or construction activities/business activities performed in the state are deemed Michigan receipts.[27]

Fluor paid the tax under protest and filed an appeal in the Court of Claims where the parties filed cross motions for summary disposition. The Court of Claims denied the Department's motion and granted Fluor's. The Court, in its bench opinion, adopted Fluor's construction of subsection (c) that limited Michigan sales to services performed in Michigan for construction projects in Michigan.[28] Addressing the Department's point that such a construction renders subsection (c) a duplication of subsection (a) that also states that services performed in Michigan are Michigan sales, the Court of Claims held:[29]

> Plaintiff adequately refutes the Defendant's argument by way of an example Plaintiff used wherein a company manufactures prefabricated buildings where the components are built outside of the state then shipped across state lines and ultimately assembled and affixed to a foundation in Michigan. . . . So clearly by way of analogy with that example, the Court finds that adopting at [sic] the Plaintiff's interpretation of section 53(c) does not render that subsection nugatory.

The Department filed its claim of appeal to the Court of Appeals on September 17, 2003, to correct the lower court's error.

At the Court of Appeals the matter was briefed and then argued by both parties. On April 14, 2005, the Court of Appeals released its *per curiam* published decision that reversed the Court

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[27] Stipulation of Facts, Exhibit 2, p. 5, Appellant's Appendix, p 26a.
[28] Court of Claims transcript, pgs 18-21, Appellant's Appendix, p 31a-32a.
[29] Court of Claims transcript, pgs 20-21, Appellant's Appendix, p 31a-32a.

of Claims determination that § 53(c) of the SBTA limited Michigan sales to services performed in Michigan. As stated by the Court of Appeals at pg. 7 of the slip Opinion:[30]

> In summary, § 53(c) is not ambiguous, i.e., it does not irreconcilably conflict with another provision and is not equally susceptible to more than a single meaning. *Mayor of Lansing*[31], *supra* at 165-166. Rather, in its grammatical context, the last antecedent for "within this state" is "activities." Accordingly, receipts derived from services performed for construction activities within this state shall be deemed Michigan receipts for the purposes of the sales factor. The parties agreed that the challenged receipts were for services "that related to real estate improvement projects constructed in Michigan." Thus, these receipts were derived from services performed for construction activities within this state. The Court of Claims incorrectly interpreted the statute.

Having found that the Court of Claims had erroneously interpreted the statute in question, the Court of Claims then examined Fluor's Commerce Clause challenge to the tax at issue, which had not been examined by the Court of Claims as the Court of Claims had accepted Fluor's interpretation of § 53(c). The Court of Appeals correctly noted that an examination of a Commerce Clause challenge to a State tax encompasses a review of the four-part test set forth by the U. S. Supreme Court in the case of *Complete Auto Transit, Inc v Brady*, which provides that a state tax is constitutionally valid under the Commerce Clause provided that the tax: "(1) is applied to an activity having a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state."[32] As Fluor had only raised a challenge in its original complaint to the tax under the first two prongs of the test noted above, the Court of Appeals only examined those first

[30] Court of Appeals decision, pg 7, Appellant's Appendix p 41a.
[31] *Mayor of City of Lansing v Public Service Comm*, 470 Mich 154; 680 NW2d 840 (2004).
[32] *Complete Auto Transit, Inc v Brady,* 430 US 274, 279; 97 S Ct 1076; 51 L Ed 2d 326 (1977).

and second prongs of the test, finding that the tax at issue was applied to an activity having a substantial nexus with the taxing state but that the tax at issue was not "fairly apportioned."[33]

In determining whether the tax at issue was "fairly apportioned" so as to pass a Commerce Clause challenge, the Court of Appeals, at pg 10 of its slip Opinion,[34] correctly noted that two components must be satisfied: the tax must be both "internally" and "externally" consistent. "Internal consistency" means that "a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result[.]"[35] "External consistency" examines whether the choice of factors used in apportionment "reasonably reflects the in-state component of the activity being taxed."[36] As Fluor did not challenge the external consistency component the Court of Appeals examined only the internal consistency component, finding that the tax at issue failed the internal consistency test. As noted by the Court of Appeals at page 10-11 of its Slip Opinion[37]:

> Section 53(c), as interpreted by defendant, fails the internal consistency test. If other states used the same apportionment formula, there are situations where more than one state would tax business activity performed in one state for construction activities in another. This is demonstrated by consideration of a scenario where a company performed services both in Michigan and out of state (for this example Ohio) for construction activities in Michigan. Under defendant's interpretation of § 53(c), the receipts derived from both the in-state and out-of-state services are deemed Michigan receipts. For the internal consistency analysis, one assumes that other jurisdictions are using the same apportionment formula. If Ohio had the same apportionment formula, its ability to tax the business activity in Michigan and Ohio would depend on § 53 (b). If the greater proportion of the business activity as measured by cost of performance occurred in Ohio, then the sale is an Ohio sale and would be used in the Ohio sales factor. In this situation, the taxpayer's business activity (services performed in Ohio and Michigan) would be included in the sales factor of both jurisdictions' apportionment formula. As a

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[33] For all practical purposes the "internal consistency" test was raised *sua sponte* by the Court of Appeals in its April 14, 2005 Opinion. Neither party really briefed or argued the issue before that time.
[34] Court of Appeals decision, pg 10, Appellant's Appendix p 44a.
[35] *Goldberg v Sweet,* 488 US 252, 261; 109 S Ct 582; 102 L Ed 2d 607 (1989).
[36] *Goldberg,* 488 US at 262.
[37] Court of Appeals decision, pgs 10-11, Appellant's Appendix p 44a-45a.

> result, the provision places interstate commerce at a competitive disadvantage with interstate commerce. Thus § 53 (c), as interpreted by defendant, fails the internal consistency component of the fair apportionment prong of the *Complete Auto, supra,* test and violates the Commerce Clause.

After the Court of Appeals decision the Department filed a timely Motion For Reconsideration/and or Rehearing with the Court of Appeals in regard to the Court of Appeals' determination that § 53(c) violated the Commerce Clause. Additionally, the Department contended that the Court of Appeals had erred in its characterization of the Department's interpretation of § 53(c). On June 10, 2005 the Court of Appeals issued its Order denying the Department's Motion. It was from the Court of Appeals decision that § 53(c) violates the Commerce Clause, as well from the Court of Appeals' erroneous determination of the Department's position, that the Department sought this Court's leave to appeal, which was granted on March 29, 2006.

ARGUMENT

I. Section 53(c) of the Single Business Tax Act, MCL 208.53(c), does not violate the Commerce Clause.

A. Standard of Review

This action does not involve any controverted facts. The question presented is a question of law subject to *de novo* review.[38]

B. Section 53(c) does not violate the internal consistency test of the Commerce Clause.

The Commerce Clause provides that "Congress shall have the Power . . . [t]o Regulate Commerce . . . among the several States." US Const, art I, § 8, cl 3. "Though phrased as a grant of regulatory power to Congress, the Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce."[39]

In *Western Live Stock v Bureau of Revenue,*[40] the United States Supreme Court noted that "[i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business."[41] In *Complete Auto Transit, Ind v Brady,*[42] the United States Supreme Court noted that its prior decisions established that it is not the formal language of the tax statue but rather its practical effect that is determinative. The Court then held that a state tax would survive a Commerce

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[38] *Cardinal Mooney High School v Michigan High School Athletic Assoc*, 437 Mich 75, 80; 476 NW2d 21 (1991).
[39] *Oregon Waste Systems, inc v Dep't of Environmental Quality of the State of Oregon*, 511 US 93, 98; 114 S Ct 1345; 128 L Ed 2d 13 (1994)
[40] *Western Live Stock v Bureau of Revenue*, 303 US 250, 58 S Ct 546; 82 L Ed 823 (1938).
[41] *Western Live Stock*, 303 US 254.
[42] *Complete Auto Transit, Inc v Brady*, 430 US 274; 97 S Ct 1076; 51 L Ed 2d 326 (1977).

Clause challenge when the tax (1) is applied to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services proved by the State.[43]

Fluor claims that § 53(c) of the SBTA does not satisfy the second prong of the *Complete Auto* test, i.e., that it is not fairly apportioned. Since 1983, the U. S. Supreme Court has used the principle of "internal consistency" when determining whether a state tax is fairly apportioned under the Commerce Clause.

The internal consistency test was first discussed by the United States Supreme Court in *Container Corp v Franchise Tax Bd.*[44] In *Container*, the Court cited "internal consistency" as an analytical tool to determine whether a state's apportionment formula was fair. Under the internal consistency test "the [apportionment] formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed."[45] In *American Trucking Ass'ns v Scheiner,*[46] citing *Armco Inc v Hardesty,*[47] the Court explained: "To pass the 'internal consistency' test, a state tax must be of a kind that, 'if applied by every jurisdiction, there would be no impermissible interference with free trade.'" The test was intended to measure if interstate commerce was burdened if every state adopted the same type of tax. In *Oklahoma Tax Commission v Jefferson Lines*, the Court reiterated that the internal consistency test examined the form and structure of a tax as follows[48]:

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[43] *Complete Auto,* 430 US 279.
[44] *Container Corp v Franchise Tax Bd.* 463 US 159, 169; 103 S Ct 2933; 77 L Ed 2d 545 (1983).
[45] *Id.*
[46] *American Trucking Ass'ns v Scheiner*, 483 US 266, 284; 107 S Ct 2829; 97 L Ed 2d 226 (1987).
[47] *Armco Inc v Hardesty,* 467 US 638, 644; 104 S Ct 2620; 81 L Ed 2d 540 (1984).
[48] *Oklahoma Tax Commission v Jefferson Lines*, 514 US 175, 185; 115 S Ct 1331; 131 L Ed 2d 261 (1995).

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the degree of economic reality reflected by the tax, **but simply looks to the structure of the tax at issue** to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax. (emphasis added).

In this case the Court of Appeals found that § 53 of the SBTA was unconstitutional because it resulted in the single business tax base being unfairly apportioned. [49] The Court of Appeals' conclusion arose from its erroneous application of the "internal consistency test." As noted earlier, § 53 of the SBTA provides that[50]:

> Sales, other than sales of tangible personal property, are in this state if:
>
> (a) The business activity is performed in this state.
> (b) The business activity is performed both in and outside this state and, based on costs of performance, a greater proportion of the business activity is performed in this state than is performed outside this state.
> (c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed Michigan receipts.

Testing § 53 for internal consistency, the Court of Appeals created a hypothetical situation and examined the results if Ohio adopted the same tax provision. But in doing so, the Court of Appeals erroneously concluded that § 53(b) was applicable for apportioning business activity to Ohio where the same activity was apportionable to Michigan under § 53(c)[51]:

> If Ohio has the same apportionment formula, its ability to tax the business activity in Michigan and Ohio would depend on § 53(b). If the greater proportion of the business activity as measured by cost of performance occurred in Ohio, then the sale is an Ohio sale and would be used in the Ohio sales factor. In this situation, the taxpayer's business activity (services performed in Ohio and Michigan) would be included in the sales factor of both jurisdictions' apportionment formula.

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[49] Court of Appeals decision p 11, Appellant's Appendix p 45a.
[50] MCL 208.53
[51] Court of Appeals decision p 10-11, Appellant's Appendix p 44a-45a.

The Court of Appeals erred by not using § 53(c) to apportion business activity in a consistent manner. Evidently, the Court of Appeals below was misled by the Legislature's use of the word "Michigan" in subdivision (c) to identify the taxing State, while subdivisions (a) and (b) refer to "this state." The Court of Appeals could only have concluded that the same business activity would be included in the sales factor of both jurisdictions if it found that § 53(c) was limited to Michigan's apportionment formula. The only basis for this conclusion is that § 53(c) uses the term "Michigan" rather than "this state." While it is true that when applied for Michigan purposes the terms are synonymous, when examining for internal consistency it is clear that the term "Michigan" should be substituted with the name of the other taxing State that is being compared to Michigan. In its hypothetical example of the language a similar Ohio statute would provide, the Court of Appeals should have substituted "Ohio" for "Michigan" in § 53(c). This would have resulted in the Court of Appeals realizing that if the greater part of the construction activity, as measured by cost of performance, took place in Ohio, then the sale would be an Ohio sale and only used in the Ohio sales factor—not in Michigan's.

While the Court of Appeals below correctly stated that a statute is tested for internal consistency by analyzing the result if every State adopted a like measure, the Court of Appeals erred by not recognizing that if every State were to adopt § 53 each would substitute its own State's name for "Michigan" under subdivision (c). The problem with the Court of Appeals' analysis is that any statute that identifies the State by name rather than the common noun "state" could flunk the internal consistency test.

The Court of Appeals may also have been misled by the U. S. Supreme Court's use of the word "identical" in *Jefferson Lines,*[52] as meaning that the tax's verbatim text must be used

[52] *Oklahoma Tax Commission v Jefferson Lines*, 514 US 175, 185; 115 S Ct 1331; 131 L Ed 2d 261 (1995)

by other States to test for internal consistency. But as used by the Supreme Court, "identical" refers to identical formula and structure, not identical text when identifying the taxing State. Otherwise the Court's admonition that the test "simply looks to the structure of the tax at issue" would have no meaning.

Most recently in the case of *American Trucking Association, Inc and USF Holland, Inc v Michigan Public Service Commission*, the U.S. Supreme Court again explained the application of the "internal consistency" test, where it indicated that the "internal consistency" test is[53]:

> a test that we have typically used where taxation of interstate transactions are at issue. Generally speaking, that test asks, "what would happen if all States did the same?" See, *e.g., Goldberg v. Sweet*, 488 U.S. 252, 261, 102 L. Ed. 2d 607, 109 S. Ct. 582 (1989); *Jefferson Lines,[54] supra*, at 185, 131 L. Ed. 2d 261, 115 S. Ct. 1331 (test looks to the structure of the tax to see whether its identical application by every State "would place interstate commerce at a disadvantage as compared with commerce intrastate").

The Court of Appeals did not apply § 53 as if other States adopted a tax with the same "structure" or "formula" as § 53, but, rather applied § 53 as if other States adopted a tax with the identical text as § 53, including identifying Michigan as the taxing jurisdiction. The Court of Appeals did not test the structure of § 53. Rather, it tested draftsmanship by basing its analysis on whether the Legislature used a common or proper noun when referring to the taxing state.

To properly test § 53 the Court must read Ohio's hypothetical adoption of § 53 to read:

> Sales, other than sales of tangible personal property, are in this state if:
>
> * * *
>
> (c) Receipts derived from services performed for planning, design, or construction activities within this state shall be deemed [Ohio] receipts.

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[53] *American Trucking Association, Inc and USF Holland, Inc v Michigan Public Service Commission*, ___ US ___; 125 S Ct 2419, 2425; 162 L Ed 2d 407 (2005).
[54] *Oklahoma Tax Commission v Jefferson Lines*, 514 US 175, 185; 115 S Ct 1331; 131 L Ed 2d 261 (1995)

If Ohio had the same apportionment formula as Michigan there would be no double taxation because business activity performed for construction projects would be sourced to the state where the construction occurs. If construction was in Michigan, Michigan and Ohio would source the business activity to Michigan. If construction was in Ohio, Michigan and Ohio would source the business activity to Ohio. This is consistent with the Supreme Court's jurisprudence and renders § 53 internally consistent. Only one State would be taxing the business activity.

The Court of Appeals erred when testing internal consistency by using a hypothetical under which Ohio's statute would not apply receipts derived from services performed for Ohio construction projects to Ohio.

Based on this error it is not unexpected that the Court of Appeals found § 53 internally inconsistent since the Court of Appeals was comparing apples to oranges. Rather than compare the resulting tax if Michigan and Ohio adopted mirror versions of § 53(c), the Court of Appeals looked at the resulting tax by applying § 53(c) to Michigan and § 53(b) to Ohio. The Court of Appeals did not use the same apportionment formula or structure when examining the result for Ohio and the Court of Appeals' failure to do so is palpable error.

Finally, Courts have a duty to construe statutes in a manner that render them constitutional, if possible.[55] The Courts are also guided by the principle that a statute is presumed constitutional absent a clear showing to the contrary;[56] and that the presumption of constitutionality is especially strong with respect to taxing statutes.[57]

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[55] *People v Haynes,* 421 Mich 271, 284; 364 NW2d 635 (1984).
[56] *Lehnhausen v Lake Shore Auto Parts Co,* 420 US 356, 364; 93 S Ct 1001; 35 L Ed 2d 351 (1973).
[57] *County of Washtenaw v State Tax Comm,* 422 Mich 346, 371; 373 NW 2d 697 (1985), citing *Thoman v City of Lansing,* 315 Mich 566, 576; 24 NW 2d 213 (1946).

This Court should correct the error of the Court of Appeals by properly applying the internal consistency test so as to render the statute constitutional.

C. The Court of Appeals incorrectly characterized the Department's construction of § 53(c).

In its opinion the Court of Appeals held that[58]:

> Section 53(c), **as interpreted by defendant**, fails the internal consistency test. If other states used the same apportionment formula, there are situations where more than one state would tax business activity performed in one state for construction activities in another. This is demonstrated by consideration of a scenario where a company performed services both in Michigan and out of state (for example, Ohio) for construction activities in Michigan. **Under defendant's interpretation of § 53(c), the receipts derived from both the in-state and out-of-state services are deemed Michigan receipts.** For the internal consistency analysis, one assumed that other jurisdictions are using the same apportionment formula. **If Ohio had the same apportionment formula, its ability to tax the business activity in Michigan and Ohio would depend on § 53(b).** If the greater proportion of the business activity as measured by cost of performance occurred in Ohio, then the sale is an Ohio sale and would be used in the Ohio sales factor. In this situation, the taxpayer's business activity (services performed in Ohio and Michigan) would be included in the sales factor of both jurisdictions' apportionment formula. [Emphasis added].

The Department's interpretation of § 53(c) does not lead to the result assumed in the quoted portion of the Court of Appeals' Opinion. The Department interprets § 53(c) as treating services performed for a construction project as sales of the State where the construction project takes place. Under the Department's interpretation of § 53, using the scenario described by the Court of Appeals, § 53(c) would apply to services performed for Ohio construction projects. Therefore, receipts derived for services performed for Ohio construction projects are included in the Ohio sales apportionment formula. This maintains the tax's structure where services performed for Michigan construction projects are included in the Michigan sales apportionment factor. The Court of Appeals incorrectly assumed that the Department would apply § 53(b) to

[58] Court of Appeals decision, pgs 10-11, Appellant's Appendix p 44a-45a.

receipts derived from services performed for Ohio construction projects ("Section 53(c), as interpreted by defendant, fails the internal consistency test. . . . If Ohio had the same apportionment formula, its ability to tax the business activity in Michigan and Ohio would depend on § 53(b)."). The Court of Appeals erroneously concluded that the Department interprets § 53(c) as only applying to Michigan's sales apportionment factor and that subdivision (b) would apply to other scenarios involving construction activities.

That is why the statute is theoretically tax neutral: services performed for construction projects are sourced to the sales apportionment factor of the State where construction occurs.

The Department has historically interpreted § 53(c) as sourcing services performed for construction projects to the State where the construction occurs. This position was expressed by instructions to the Department's audit staff. (A memorandum outlining these instructions was attached as Attachment 1 to the Department's Reply Brief in the Court of Appeals.[59]) Auditors were advised that "services related to Michigan construction activities are by statute Michigan receipts, [therefore] similar receipts received by a Michigan based company, subject to apportionment, for construction activities in other states cannot be attributed to Michigan."[60] These instructions illustrate that the Department's interpretation of MCL 208.53(c) requires sourcing receipts from services performed for construction projects to the State where the construction takes place. The Department did not instruct its auditors that § 53(b) applied to construction activities in other States. The memorandum did not instruct auditors to determine whether the greater proportion of the business activity as measured by cost of performance occurred in Michigan. The auditors were instructed that these sales were not Michigan sales. Thus, there is no double taxation and § 53(c) is internally consistent.

[59] Appellant's Appendix, p 10a.
[60] Appellant's Appendix, p 10a

CONCLUSION

The Court of Appeals correctly held that when enacting MCL 208.53(c) the Legislature intended that services performed for Michigan construction projects are treated as Michigan receipts. Under the internal consistency test, if other States adopted a provision like § 53 they too would source services performed for construction activities in their States to their States. Section 53(c) should be construed to the effect that receipts derived from services performed for construction projects in other States are receipts included in the sales apportionment factor of the State where the construction occurs. Such construction renders the statute constitutional and is consistent with the Department's administration of § 53(c). The failure of the Court of Appeals to interpret § 53(c) in this manner was incorrect as a matter of law.

RELIEF SOUGHT

Wherefore, Defendant-Appellant Revenue Division, Department of Treasury, State of Michigan prays that this Court reverse the holding of the Court of Appeals and declare that § 53(c) of the Single Business Tax Act does not violate the Commerce Clause of the U. S. Constitution.

Respectfully submitted,

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